Office - Supreme Court, U. S.
FILED
JUN 19 1950
CHARLES ELMORE CROPLEY
CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1950.

No. 137

THE NEW BRUNSWICK TRUST COMPANY, *Petitioner,*

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent.*

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT AND BRIEF IN SUPPORT THEREOF.

MARTIN W. MEYER,
Counsel for Petitioner,
817 Munsey Building,
Washington 4, D. C.

Of Counsel:
ROBERT HOLT MYERS,
817 Munsey Building,
Washington 4, D. C.

PRESS OF BYRON S. ADAMS, WASHINGTON, D. C.

INDEX.

Petition for Writ of Certiorari.

	Page
I. Jurisdictional Statement	2
II. The Question Which Is Here Presented	2
III. The Statute Involved	2
IV. Statement of Matter Involved	2
(a) The Judgment Below	2
(b) Statement of Case	3
V. Reasons Relied Upon for Allowance of the Writ	6

Brief in Support of Petition for Writ of Certiorari.

Opinions Below	9
Jurisdiction	9
Statement of the Case, Etc.	10
Specification of Errors to Be Urged	10
Argument	10
Controlling Decision of the Court of Claims	10
Controlling Decision of the Court of Appeals	15
Conclusion	19

LIST OF CASES.

Clinton Trust Company v. *Commissioner*, 52 F. Supp. 671 (1943) 6, 7, 10, 11, 12, 13, 14, 15

Farmers & Merchants Bank v. *Commissioner*, 175 F. 2d 846 (1949) 6, 7, 15, 16, 17, 18

New Brunswick Trust Company v. *Commissioner*, 180 F. 2d 959 ..... 1, 9, 14, 15

STATUTES CITED.

Title 28, U. S. C., Section 1254(1) 2, 9

Section 3798 of the Internal Revenue Code 2, 5, 6, 10, 14, 16, 19

IN THE

Supreme Court of the United States

OCTOBER TERM, 1950.

No.

THE NEW BRUNSWICK TRUST COMPANY, *Petitioner,*

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent.*

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT.

To the Honorable The Chief Justice and Associate Justices of the Supreme Court of the United States:

Your petitioner, by its counsel, prays that a Writ of Certiorari be granted to remove into your Honorable Court for review a judgment of the United States Circuit Court of Appeals for the Third Circuit entered on May 23, 1950 (R. 35), *New Brunswick Trust Company* v. *Commissioner,* 180 F. 2d 959, in which that court affirmed a decision of the Tax Court of the United States (R. 3a, 12a).

I. Jurisdictional Statement.

The Judgment of the Circuit Court of Appeals of the Third Circuit was entered on May 23, 1950 (R. 35). The jurisdiction of this court is invoked under Title 28, U. S. C., Section 1254(1).

II. The Question Which Is Here Presented.

Did the depositors, who released part of their claims against an insolvent bank so as to permit the bank to reopen, acquire, under the plan of reorganization and the circumstances surrounding the issuance of the preferred stock, a lien upon the subsequent earnings of the bank within the purpose and intent of Section 3798(b) of the Internal Revenue Code?

III. Statute Involved.

Section 3798(b) of the Internal Revenue Code:

Exemption of Insolvent Banks from Tax.

IV. Statement of Matter Involved.

(a) The Judgment Below.

Respondent, the Commissioner of Internal Revenue determined a deficiency in petitioner's Federal income tax for the taxable year 1945, in the amount of $22,030.15, and a deficiency in declared value excess profits tax of $3,241.57 (R. 15a). Petitioner filed a petition with the Tax Court of the United States for a redetermination of the deficiency, asserting exemption from taxation under the provisions of Section 3798(b) of the Internal Revenue Code (R. 1a). The Tax Court ordered and decided that there was no exemption for the petitioner under the terms of the statute (R. 3a). The petitioner appealed to the Circuit Court of Appeals for the Third Circuit, which Court affirmed the decision of the Tax Court (R. 30).

(b) Statement of Case.

The petitioner, a New Jersey banking corporation, was closed by order of the New Jersey State Banking Commissioner in June, 1933. So as to achieve solvency, several plans of reorganization were drafted by a committee of the depositors, but these were rejected by the banking department of the state of New Jersey (R. 13a). Finally, a plan was adopted by a committee of depositors which received the sanction of the Commissioner of Banking. The plan provided:

(1) All deposits of $5 or less were to be paid in full together with 2½% of all other deposits (R. 16a and 22a).

(2) 50% of all the remaining deposits was to be converted into new preferred stock with a par value of $10 a share, the same to bear a cumulative dividend of 3% on par. The new preferred stock was to be charged to the deposits at the rate of $30 a share, was to have voting power equal to the common, and was to be retired at $30 a share (R. 16a and 22a).

(3) The remaining 50% of the depositors' accounts was to be paid off in installments as rapidly as possible from the accumulation of cash using all net earnings and funds that could be released without endangering the strength of the bank (R. 23a and 17a).

(4) The common stock of the corporation was to be revalued and redistributed, with existing stockholders receiving 33% of the new common stock (plus 16% upon the satisfaction of claims of the mortgage bondholders), and the unsecured depositors were to receive the remaining 51% (R. 17a and 22a-23a).

(5) The depositors were to release their claims against the bank (R. 19a).

The law of New Jersey required that consents representing 75% of the deposits were necessary before the plan could be adopted. At first the committee failed to obtain

the required number of consents for the plan; so the committee of depositors circulated a pamphlet among the reluctant depositors and officers of the bank personally solicited depositors in order to obtain enough consents to meet the minimum requirements (R. 14a).

Representations were made by pamphlet and personal solicitation that:

(1) A failure to obtain the required number of consents would result in liquidation, and it would not be possible to estimate what the depositors would receive on liquidation or how long they would have to wait (R. 21a-22a).

(2) The preferred stock was to be retired at $30 a share as soon as the remaining balance of the unsecured deposits had been retired (R. 22a-23a).

(3) Such redemption would take place as soon as the bank's assets, which were on hand when the company closed, and the earnings of the trust company in the future allowed the directors to redeem the stock at that amount (R. 14a).

(4) The common stockholders would receive nothing by way of dividends or otherwise until the preferred stockholders were paid in full, and the preferred stock to be issued would contain appropriate clauses to that effect (R. 14a).

(5) The new common stock would have only potential value until the preferred stock was retired (R. 23a).

(6) The preferred stock would give the depositor a preference on all future earnings of the bank (R. 14a).

It is stipulated that *most of the depositors consented to the plan of reorganization in reliance on such representations (R. 14a).*

The solicitation was successful in that enough additional consents were thus obtained so as to permit the adoption of the plan of reorganization (R. 14a).

In December, 1933, the petitioner reopened for business and preferred stock was issued to the former depositors, containing the statement that—

> "The Board of Directors *may* declare dividends payable on the common stock *only after* the entire preferred capital stock issued *shall* be retired at $30.00 per share, together with all cumulative dividends." (R. 27a) [Emphasis supplied].

In 1941 the unsecured deposits, other than those released and for which the preferred stock was substituted, were liquidated out of the old assets on hand at the time of the reorganization (R. 15a). By the end of 1945, the tax year in question, the petitioner had not accumulated sufficient net earnings and free assets to retire the preferred stock (R. 15a); so no preferred stock had been retired *by that time.*

The issue arose out of the exemption claimed by the petitioner under Section 3798(b) of the Internal Revenue Code. Section 3798 relates to the exemption of insolvent banks from tax, and Paragraph (b) provides in part—

> "Whenever any bank * * * has been released or discharged from its liability to its depositors for any part of their claims against it, and such depositors have accepted, in lieu thereof, a lien upon subsequent earnings of such bank * * *, no tax shall be assessed or collected * * * on account of such bank * * * which shall diminish the assets thereof which are available for the payment of such depositor claims and which are necessary for the full payment thereof."

Petitioner claimed that the old depositors of the bank accepted a lien on the bank's earnings in lieu of part of their claims against the bank under the plan of reorganization which was adopted.

The court below narrowly construed the relation of the parties and, stressing the preferred stock certificate which was issued, determined that the holders of the preferred stock became owners of the corporation as contrasted to

holders of a lien against the bank (R. 33). In so holding, it came to a conclusion directly in conflict with the holding of the Court of Claims in *Clinton Trust Company* v. *United States,* 52 F. Supp. 671 (1943).

The court below concluded that no lien was created by the plan of reorganization, and in so doing, in effect disregarded the promises, both written and oral, made to the depositors to induce them to join the plan (R. 33-34). The failure to give consideration to the inducements and to consider the same as creating an equitable lien is in direct conflict with the holding of the Eighth Circuit in *Farmers and Merchants Bank* v. *Commissioner,* 175 F. 2d 846 (1949).

V. Reasons Relied Upon for Allowance of the Writ.

(a) The decision of the court below directly conflicts with the decision of the Court of Claims in *Clinton Trust Company* v. *United States,* 52 F. Supp. 671. It is also in direct conflict with the decision of the Eighth Circuit Court of Appeals in *Farmers and Merchants Bank* v. *Commissioner,* 175 F. 2d 846.

(b) The decision of the court below creates a special problem in the administration of the tax laws because a taxpayer has the choice of petitioning for a redetermination of a deficiency in the Tax Court (with an appeal to the Circuit Court) or paying a deficiency and filing a suit for refund in the Court of Claims. In the future, a taxpayer faced with a problem under Section 3798 of the Internal Revenue Code will be obliged to conclude that he will get favorable consideration if he takes it to the Court of Claims and an unfavorable one if he takes it to the Tax Court and then to the Third Circuit. If he happens to be in the Eighth Circuit, he can expect a favorable determination. If he is in any of the other circuits, he could gamble but would very probably go to the Court of Claims. A decision on this matter by this Honorable Court would clarify the issue and reestablish equal justice under law.

(c) The decision of the court below creates great confusion in the special field of the application of this particular statutory provision (first enacted in 1879 and never passed upon by this Court), not only because it is in direct conflict with the Eighth Circuit and the Court of Claims, but also it injects uncertainty of the highest degree into the recurring vital national problem of insolvent banks. The confusion as to the intent and meaning of the statute not only concerns the banks but also every depositor who finds his funds in an insolvent bank. The important fact is not merely that there is a judicial conflict but also that the decision of the lower court generates great uncertainty as to how an insolvent bank can reorganize in such a way as to protect the claims of its depositors by qualifying for the tax relief (which Congress as a matter of public policy intended to provide for the benefit of such depositors) and at the same time become solvent. It creates an extremely complex practical problem as to the importance of the formalities necessary in the reorganization of insolvent banks. Specifically—

(1) The conflict with the *Clinton Trust Company* case raises the question as to whether or not an insolvent bank can use preferred stock in a reorganization, and

(2) The conflict with the *Farmers and Merchants Bank* case raises the question as to whether or not the word "lien", as used in the statute, is to be so narrowly construed as to exclude the equitable lien—absolutely devitalizing the salutary effect Congress intended.

WHEREFORE, it is respectfully submitted that the petition should be granted.

MARTIN W. MEYER,
Counsel for Petitioner,
817 Munsey Building,
Washington 4, D. C.

Of Counsel:

ROBERT HOLT MYERS,
817 Munsey Building,
Washington 4, D. C.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1950.

No.

THE NEW BRUNSWICK TRUST COMPANY, *Petitioner,*

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent.*

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

Opinions Below.

The opinion of the Tax Court of the United States is printed in the Record at pages 3a to 11a and that of the Circuit Court of Appeals for the Third Circuit is printed in the Record at pages 30-34.

Jurisdiction.

The judgment of the Circuit Court of Appeals for the Third Circuit was entered on May 23, 1950 (R. 35), *New Brunswick Trust Company* v. *Commissioner,* 180 F. 2d 959. The jurisdiction of this Court is invoked under Title 28, U. S. C., Section 1254(1).

Statement of the Case, Etc.

A statement of the case and the question presented already appear in the foregoing petition at pages 2 to 6, *supra.*

Specification of Errors to be Urged.

The court below erred in—

(1) Failing to find that the petitioner was exempt under Section 3798(b) of the Internal Revenue Code from the payment of Federal income and excess profits taxes for the year 1945, and

(2) Affirming the decision of the Tax Court.

ARGUMENT.

It is uniformly understood that a denial of a petition for certiorari in no sense purports approval of the decision below, and it follows that a denial of the petition in this case could not be construed otherwise than an invitation to the taxpayers to avoid, if at all possible, one branch of the judicial arm and seek out another. The conflict between the Third Circuit and the Court of Claims is patent.

Decision of the Court of Claims.

It would be very difficult to find a case so identical in facts to the one urged as the *Clinton Trust Company* case, 52 F. Supp. 671. The reorganization plans are so parallel that they are set up below in columnar fashion to illustrate the amazing parallel.

CLINTON TRUST COMPANY	NEW BRUNSWICK TRUST COMPANY
I. *Statute*	
Section 3798(a), Internal Revenue Code (Section 22(a) of the Act of March 1, 1897, as amended by the Internal Revenue Act of 1938) relating to exemption of insolvent banks.	Same
II. *Subject of Dispute*	
Taxes	Same
III. *Business of Taxpayer*	
A New Jersey bank trust company, a substantial portion of whose business consisted of receiving deposits and making loans and discounts.	Same
IV. *Status of Business*	
Due to insolvency bank closed and operation suspended 1933; remained closed until reorganization plan adopted and effected 1934.	Same (Except opened 1933.)
V. *The Plan of Reorganization*	
(a) *Recapitalization*	
(1) Class A, 5%, preferred stock created to be sold to RFC to raise funds to cover anticipated unusually large withdrawals upon the reopening. (N. B.—Contrary to expectation, withdrawals light, and fund proved unnecessary; Class A retired by mutual agreement with the RFC.)	(1) No Parallel (Freezing of 47½% of deposits made withdrawals impossible and fund unnecessary.)
(2) Class B, 3%, preferred stock created.	(2) Same (Except single class and cumulative.)

(3) Value of the common stock written down to $1. No dividends to be received until all preferred stock retired.	(3) Same (Except common stock also recapitalized—par reduced from $100 to $10 and number of shares correspondingly increased.)
(b) *Treatment of Claims of Depositors*	
(1) Depositors to receive 50% of their deposits in the reorganized bank *all* subject to immediate withdrawal. (N. B.—As noted above, the sale of the preferred A to the RFC was to obtain the necessary cash, but it unexpectedly developed that such cash was not needed.)	(1) Same (Except only 2½% of which was subject to immediate withdrawal, with 47½% frozen but to be made available in installments as rapidly as possible from the accumulation of cash, using all net earnings and funds that could be released without endangering the strength of the bank, completed 1941.)
(2) Depositors to receive in lieu of 50% of their claims: (a) 25% in Class B, 3%, preferred stock ($25 par but redeemable at $50 and charged against the deposits at $50.) (b) 25% in participation certificates against segregated assets.	(2) Depositors to receive in lieu of 50% of their claims: (a) *All* in 3% cumulative preferred stock ($10 par but redeemable at $30 and charged against the deposits at $30.)
(3) Depositor-creditors gained voting control. Common stock lost voting rights.	(3) Same (Except the depositors received 51% of new common stock having voting rights.)
(4) Depositors released bank from their claims against the bank.	(4) Same
(c) *Method of Redemption*	
(1) Until the retirement of preferred A (20 months) net profits to be applied in the following order:	(1) Frozen deposits to be made available in installments as rapidly as possible from the accumulation of cash,

(a) 10% to surplus fund until such fund equals 20% of the capital stock.	using *all* net earnings and funds that could be released without endangering the strength of the bank.
(b) Sums necessary to pay dividend on preferred A.	
(c) 40% of remainder to pay A retirement fund.	
(d) Balance to other lawful purposes.	
(2) After (1) completed, net profits to be applied as in (1) until the retirement of preferred B.	(2) After (1) completed, net earnings and other funds to be applied as in (1) until the retirement of the preferred stock.

It is noted that there are but two significant variations in the two reorganization plans. The first is that the Clinton Trust Company borrowed funds to satisfy the expected demands on the part of the depositors upon the reopening of the bank. The New Brunswick Trust Company, on the other hand, did not borrow funds but chose to freeze the deposits looking to the liquidation of the bank's assets and the future earnings of the bank as the means of repayment. This variation accounts for the additional class of preferred stock in the Clinton Trust Company reorganization and also accounts for the slight variation in the treatment of 50% of the claims of the depositors. The intention in both cases, however, was the same.

The second variation (the one that was fatal to the *Clinton Trust Company* case) is found in the method of redemption. The Clinton Trust Company Plan called for [See V (c)(1)(d), above] a percentage redemption system and included a provision for any balance of the net profits to be used for other lawful purposes. On the other hand, the New Brunswick Trust Company Plan provided that *all* of the net earnings that could be released should be used to liquidate the claims of depositors.

The Court of Claims in the *Clinton Trust Company* case held that the holders of the B stock had a "lien" within the meaning of the statute, but they found as a matter of fact that taxes could be collected out of the balance for other lawful purposes, which balance represented earnings of the bank, which, if not paid out for taxes, would still *not* be paid to the depositors. The Clinton Trust Company thus had failed to comply with the terms of the statute, wherein exemption is granted *where payment would diminish assets available for the payment of depositors' claims.* In the case of the New Brunswick Trust Company, the claims of the depositors were to be liquidated from the accumulation of cash using *all* net earnings and funds that could be released without endangering the strength of the bank. Thus, the taxes in the *New Brunswick Trust Company* case would be collected out of funds which otherwise *would* be used and *were* necessary to pay off the depositors' claims.

In the *Clinton Trust Company* case, the Court of Claims noted that the tax policy as expressed by Section 3798 of the Internal Revenue Code is that the Federal government does not desire as a tax gatherer to compete with disappointed depositors of an insolvent bank, and thus is willing to defer a collection of its taxes in order to make available to such depositors money which has been set aside for the depositors. It further noted that the purpose of the statute is remedial and should be liberally construed. It held that the "lien upon subsequent earnings" of which the statute speaks is nothing more than—

> "* * * a preferential right in such earnings, made superior, by the reorganization agreement, to rights which other persons would have had but for the agreement." (*Clinton Trust Co.* v. *United States,* 52 F. Supp. 671, 679)

and that Congress could not have intended a "lien" in the sense of a security interest as there could hardly be a lien in that sense upon subsequent earnings. More important

to the present cause, the Court held that *the plan of reorganization gave the holders of the preferred stock (B) a "lien" upon certain net earnings of the corporation within the meaning of the statute.*

By contrast, under almost identical circumstances, the court below held that—

> "The shareholders, preferred and common, are the owners of a corporate enterprise, not lien creditors or even general creditors." (R. 33)

and further that neither the representations made to the depositors nor the terms of the preferred stock certificate contain anything which creates a lien. The lower court went so far as to state that it would take "a soaring imagination to turn a shareholder into one who has a lien."

The petitioner respectfully suggests that the status of the old depositors in the *Clinton Trust Company* case is identical with the status of the old depositors in the *New Brunswick Trust Company* case.

The lower court held that the reorganization transaction when analyzed showed a shift in the status of the depositors,—as depositors they were creditors, and as creditors of a bank which had failed, their chances of being paid were probably only moderately good.

> "To move matters along and to keep the bank itself going, they shifted from the position of creditors to that of owners." (R. 33)

Such analysis would apply equally to the depositors in the *Clinton Trust Company* case, yet the Court of Claims held, and we submit correctly held, that the depositors had a lien on subsequent earnings.

Decision of Court of Appeals.

A factual comparison of the *Farmers & Merchants Bank* case, 175 F. 2d 846, with the *New Brunswick Trust Company* case does not produce such a striking parallel, because apparently at the time of the bank failures of 1932

and 1933, plans of reorganization followed a geographical pattern and the plan adopted by the Farmers & Merchants Bank was the one prevalent in the Mid-West. However, the interpretation given to the word "lien", as used in Section 3798 of the Internal Revenue Code by the Third Circuit in this case, is directly in conflict with the interpretation thereof by the Eighth Circuit in the *Farmers & Merchants Bank* case. The Eighth Circuit held that there was a lien within the meaning of that section if a depositor had a right which he could enforce in a court of equity against the subsequent earnings of the bank. The Third Circuit held that such a right does not create a lien.

In the *Farmers & Merchants Bank* case the court considered the object, terms and import of the reorganization agreement, the intention of the parties in the making of the agreement, and seized upon the requirement that dividends "shall be declared" as constituting a right enforceable in a court of equity. In commenting upon the Tax Court's views in that case, which had held there was no lien because the bank could in no way be prevented from arbitrarily accumulating or making such use of the earnings as it saw fit, the Eighth Circuit Court stated as follows:

> "*We do not believe*, however, that the rights of the old depositors are entitled to be thus innocuously read under the object, terms and import of the reorganization agreement, or that *a court of equity would regard itself as being utterly impotent in the situation to effectuate those rights.*
>
> "Manifestly, the parties anticipated that the reorganized bank would be able to operate and make profits, or there could hardly have been any point in not allowing it to remain closed and be liquidated. Certainly, also, it was the intention in the making of the agreement that the relinquished deposit claims should be repaid, not as a matter of beneficence but of obligation, if the bank succeeded in making earnings from which this legally and soundly could be done. Any other interpretation would be unnatural and unreasonable. * * * " [Emphasis supplied] (*Farmers & Merchants Bank* v. *Commissioner*, 175 F. 2d 846, 848)

With respect to the requirement in the agreement in the *Farmers & Merchants Bank* case, that "dividends shall be declared when the consent therefor is obtained from the Department of Trade and Commerce, State of Nebraska", the Eighth Circuit concluded that this necessarily imposed upon the bank the obligation of taking action to make such declarations for the benefit of the old depositors. With respect thereto, the court said:

> "Of course, the old depositors would have no reach against the bank through an action at law, unless a formal dividend declaration had been made and the bank failed to make payment thereof to the depositors. But, as above suggested, *a court of equity,* it seems to us, *would not be without power of interposition, in favor of the depositors, against such earnings* as the agreement sought to charge with the repayment of the old deposit claims, under the bank's obligation to such depositors (not to the stockholders) to make declarations of dividends when they could be paid under statutory regulation and in prudent banking practice, and when the Department of Trade and Commerce would give its consent thereto. * * * " [Emphasis supplied] (*Farmers & Merchants Bank* v. *Commissioner,* 175 F. 2d 846, 848)

The court further held that by virtue thereof—

> "The depositors exacted from the bank here a specific obligation, which the bank did not have to stockholders, to make declarations of dividends from earning, for application upon their claims, * * * " (*Farmers & Merchants Bank* v. *Commissioner,* 175 F. 2d 846, 848)

The Eighth Circuit treated as a mere matter of form the provisions in the agreement for having such earnings paid to the depositors as declared stockholders' dividends, stating with respect thereto—

> "* * * *It was formality through which a court of equity could properly penetrate* in reaching to the heart of the depositors' rights, upon proof of the existence of such conditions as imposed upon the bank the duty of

> making distribution. And *proof of such conditions as would enable a court of equity to act would not be legally unproduceable.* * * *" [Emphasis supplied] (*Farmers & Merchants Bank* v. *Commissioner,* 175 F. 2d 846, 849)

After making an exhaustive survey of the meaning of the word "lien", the Eighth Circuit concluded as follows:

> "But within any recognized definition of an equitable lien, we think *a court of equity would impose such a lien,* under the reorganization agreement in the present case, upon any subsequent earnings of the bank * * *" [Emphasis supplied] (*Farmers & Merchants Bank* v. *Commissioner,* 175 F. 2d 846, 850)

The foregoing is to be compared with the situation in the present case. A sufficient number of old depositors in the New Brunswick Trust Company did not consent to the reorganization agreement until they had been promised a preference on all future earnings of the bank, and that the preferred stock would be redeemed as soon as the assets on hand and the earnings of the trust company in the future allowed the directors to redeem the stock in the amount of the released deposits. *It was stipulated that most of the depositors consented to the plan of reorganization in reliance on such representations* (R. 14a). It is submitted that where a party is induced to enter into an agreement on the basis of certain promises and representations, a court of equity will compel the other party to carry out such promises because "equity regards as done that which ought to be done." The depositors in the New Brunswick Trust Company therefore had certain rights as relinquishing depositors which they did not have as stockholders. This was a right which could be enforced in equity against the subsequent earnings of the bank and was therefore within the meaning of the word "lien" as interpreted by the Eighth Circuit in the *Farmers & Merchants Bank* case.

However, in direct conflict therewith the court below in this case held that "the representations made to the deposi-

tors'' (that is, the statement made to depositors to induce them to accept the plan including the representation that the preferred stock would be retired as rapidly as possible ''using all net earnings and funds that can be released without endangering the strength of your bank'') did not create a lien.

CONCLUSION.

It is submitted that the conflict raised by the decision of the court below creates confusion as to intent and meaning of Section 3798(b) of the Internal Revenue Code. The confusion generated by the conflict vitally affects every case in which a bank becomes insolvent and, more important, affects every depositor who may find his funds in such a bank. The only way the conflict can be resolved is for this Honorable Court to give the matter its definitive consideration.

For the foregoing reasons it is respectfully submitted that this Petition for Writ of Certiorari should be granted.

Respectfully submitted,

MARTIN W. MEYER,
Counsel for Petitioner,
817 Munsey Building,
Washington 4, D. C.

Of Counsel:
ROBERT HOLT MYERS,
817 Munsey Building,
Washington 4, D. C.

INDEX

	Page
Opinions below	1
Jurisdiction	1
Question presented	2
Statute and regulations involved	2
Statement	5
Argument	8
Conclusion	11

CITATIONS

Cases:

Clinton Trust Co. v. *United States*, 52 F. Supp. 671	9
Farmers & Merchants Bank v. *Commissioner*, 175 F. 2d 846	9
Ingersoll v. *Coram*, 211 U. S. 335	9, 10
New Jersey Title Guarantee & Trust Co. v. *Commissioner*, decided June 19, 1950	9
United States v. *Butterworth-Judson Corp.*, 267 U. S. 387	9
Walker v. *Brown*, 165 U. S. 654	9

Statute:

Internal Revenue Code, Sec. 3798 (26 U.S.C. 1946 ed., Sec. 3798)	2, 8

Miscellaneous:

T.D. 4958, 1940-1 Cum. Bull. 74, Sec. 464A.4	3

In the Supreme Court of the United States

OCTOBER TERM, 1950

No. 137

THE NEW BRUNSWICK TRUST CO., PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The findings of fact and opinion of the Tax Court (R. 3a-11a) are reported at 12 T.C. 1146. The opinion of the Court of Appeals for the Third Circuit (R. 30-34) is reported at 180 F. 2d 959.

JURISDICTION

The judgment of the Court of Appeals for the Third Circuit was entered on March 23, 1950. (R. 35.) The petition for a writ of certiorari was filed

on June 19, 1950. The jurisdiction of this Court is invoked under 28 U.S.C., Section 1254.

QUESTION PRESENTED

Taxpayer became insolvent and was closed in 1933. Pursuant to a plan of reorganization, the depositors accepted the bank's preferred stock together with fifty-one percent of its common stock in exchange for fifty percent of their claims as depositors. Preferred stock certificates provided that preferred stock was to be redeemed "at the option of" the board of directors but must be redeemed before any dividends could be paid on common. The question is whether the former depositors, now stockholders, had a lien on future earnings of the bank within the meaning of Section 3798(b) of the Internal Revenue Code so as to exempt taxpayer from tax.

STATUTE AND REGULATIONS INVOLVED

Internal Revenue Code:

> SEC. 3798. EXEMPTION OF INSOLVENT BANKS FROM TAX.
>
> * * * * *
>
> (b) Whenever any bank or trust company, a substantial portion of the business of which consists of receiving deposits and making loans and discounts, has been released or discharged from its liability to its depositors for any part of their claims against it, and such depositors have accepted, in lieu thereof, a lien upon sub-

sequent earnings of such bank or trust company, or claims against assets segregated by such bank or trust company or against assets transferred from it to an individual or corporate trustee or agent, no tax shall be assessed or collected, or paid into the Treasury of the United States on account of such bank, or trust company, such individual or corporate trustee or such agent, which shall diminish the assets thereof which are available for the payment of such depositor claims and which are necessary for the full payment thereof.

* * * * *

(26 U.S.C. 1946 ed., Sec. 3798.)

T. D. 4958, 1940-1 Cum. Bull. 74:

Pursuant to the authority contained in section 3791 of the Internal Revenue Code, and other provisions of the internal revenue laws, the following regulations are hereby prescribed:

* * * * *

Sec. 464A.4. *Scope of section generally.*—(a) *Purpose.*—The section prior to amendment by the Revenue Act of 1938 was intended to assist depositors of a bank which had ceased to do business by reason of insolvency to recover their deposits, by prohibiting collection of taxes of the bank which would diminish the assets necessary for payment of its depositors. By the amendments like assistance is given to depositors of banks which are in financial diffi-

culties but which, in certain conditions, continue in business.

(b) *Requisites of application.*—In order that the section shall operate in a case where the bank continues business it is necessary that the depositors shall agree to accept, in lieu of all or a part of their deposit claims as such, claims against segregated assets, or a lien upon subsequent earnings of the bank, or both. When such an agreement exists, no tax diminishing such assets or earnings, or both, otherwise available and necessary for payment of depositors, may be collected therefrom. If, under such an agreement, the depositors have the right also to look to the unsegregated assets of the bank for recovery, in whole or part, the unsegregated assets are likewise, until they exceed the amount of the depositors' claims chargeable thereto, unavailable for tax collection. Any tax of such a bank, or part of any tax, which is once uncollectible under the sections, can not thereafter be collected except from any residue of segregated assets remaining after claims of depositors against such assets have been paid.

* * * * *

(d) *Limitations on immunity*—The section is not primarily intended for the relief of banks as such. It does not prevent tax collection, from assets not necessary, or not available, for payment of depositors, from a bank within subsection (a), at any time within the statute of limitations. In other words the immunity of

such a bank is not complete, but ceases whenever, within the statutory period for collection, it becomes possible to make collection without diminishing assets necessary for payment of depositors. In the case of a bank within subsection (b), any immunity to which the bank is entitled is absolute except as to segregated assets. Any tax coming within such immunity may never be collected. * * *

STATEMENT

Taxpayer is a corporation organized in 1902 under the banking laws of the State of New Jersey. It is now, and at all times hereto material was, a bank or trust company within the meaning of Section 3798(b) of the Internal Revenue Code. (R. 4a.)

On June 23, 1933, taxpayer was closed by order of the Banking Commissioner of the State of New Jersey. In order to permit taxpayer to reopen, a committee of depositors proposed a plan which was approved by the New Jersey Commissioner of Banking. (R. 4a.)

The plan provided that the mortgage bondholders were to receive the proceeds from certain securities held in trust, and until their claims were finally paid they were to have the power to vote sixteen percent of the common stock to be delivered in escrow for their use. All deposits of five dollars or less were to be paid in full, together with five percent of all other deposits. Fifty percent of all remaining de-

posits were to be paid in preferred stock in the reorganized bank under the following terms (R. 4a):

> * * * The issue of preferred stock to be approximately 50,000 shares at $10.00 par value each, and charged to each depositor at the rate of $30.00 per share, the excess amount over par to be credited to surplus and reserves. The preferred stock to bear cumulative dividends at the rate of three per cent per annum on the par value and to be retired at $30.00 per share.

The remaining fifty percent of the depositors' accounts were to be paid "as and if the assets are sufficient." (R. 4a.)

In addition to the above provisions for the payment of the depositors, there was a redistribution of common stock. The 3,000 shares were increased to 30,000 and the par value decreased from $100 to $10. The stock was divided as follows (R. 5a):

To the unsecured Depositors.....	51%
To the Mortgage Bond and Participation Certificate Holders [until claims paid in full].....	16%
To the present Common Stockholders	33%

The preferred stock certificates provide (R. 5a, 27a):

> The Board of Directors may declare dividends payable on the common stock only after the entire preferred capital stock issued shall be retired at $30.00 per share together with all cumulative dividends.
>
> Upon procuring consent of the Commissioner of Banking and Insurance the preferred

> stock or any portion thereof, at the option of and in the manner determined upon by the Board of Directors, shall be subject to redemption in whole or in part at $30.00 per share and accrued dividends thereon on any dividend paying date.

Since the preferred stock has voting power equal to the common stock, the depositors acquired an eighty-one percent voting interest in the reorganized bank. (R. 5a.)

After securing the consent of the owners of seventy-five percent of the deposits, the plan of reorganization was declared adopted, and the taxpayer was reopened for business on December 23, 1933, at which time preferred stock retirable at $1,413,819.99 was issued to the former depositors. The remaining unsecured deposits in the amount of $1,424,819.39 were by December 15, 1941, and pursuant to the plan, liquidated out of the old assets on hand at the time of the reorganization. (R. 6a.)

Notwithstanding the fact that, at the end of the taxable year, the taxpayer's total accumulated net earnings and free assets constituting the amount available for the retirement of the preferred stock were $859,101.47, no part of the preferred stock issued has ever been retired. (R. 6a.)

The Tax Court held that the former depositors did not have an equitable lien on the future earnings of the bank, and, accordingly, held that the

taxpayer had not satisfied the requirements of Section 3798(b) of the Internal Revenue Code and, therefore, was not entitled to exemption. (R. 7a-11a.) The Court of Appeals affirmed. (R. 30-34.)

ARGUMENT

Section 3798(b) of the Internal Revenue Code, *supra,* provides tax exempt status for banks during the period when the payment of federal taxes would diminish the funds available to pay former depositors who have relinquished their depositors' status in exchange for a lien on subsequent earnings of the bank. It is not questioned here, as the Court of Appeals noted (R. 32), that the "single question" in the case is whether the former depositors have a lien on the taxpayer's earnings. The holdings of the courts below that former depositors who gave up that status in exchange for stock thereby gaining control of the bank do not have a lien on future earnings merely because, as taxpayer contends, the preferred stock was required to be redeemed before dividends on common stock could be paid, is not open to reasonable question.[1]

[1] Judge Goodrich stated for the Court of Appeals that (R. 33)—

> It is apparent that it is going to take a soaring imagination to turn a shareholder into one who has a lien. * * * * * * The only thing which it [preferred stock certificate] gives a shareholder not found in the usual preferred share arrangement is that it is stipulated that the dividends are to be payable on the common stock only after the entire issue of preferred stock shall be retired at $30.00 a share plus accumulated dividends. * * * we do not see how the language can be stretched to make it create a lien under the most liberal definition of that term.

See *Walker* v. *Brown,* 165 U.S. 654, 664. See also, *United States* v. *Butterworth-Judson Corp.,* 267 U.S. 387; *Ingersoll* v. *Coram,* 211 U.S. 335, 368. There is no question then that the case has been correctly decided.

The reasons advanced for the granting of the writ (Pet. 6-7) are all grounded on an asserted direct conflict of the decision below with the decision of the Court of Claims in *Clinton Trust Co.* v. *United States,* 52 F. Supp. 671, and with the decision of the Court of Appeals for the Eighth Circuit in *Farmers & Merchants Bank* v. *Commissioner,* 175 F. 2d 846. The alleged conflict is groundless.

The decision of the Court of Claims, like the decision below, resulted in a denial of the claimed exemption, although for failure to comply with a provision of the statute not in dispute here. The conclusion of the court that former depositors were lienors of future earnings plainly contributed nothing to the disposition of the case and was necessarily *obiter* dictum. In any event, the dictum is not inconsistent with the decision below but, on the contrary, supports it.[2] In *Clinton Trust Co.,* the fact that a percentage of net earnings of the

[2] The court below cited the *Clinton Trust Co.* opinion with approval (R. 32) observing that it agreed with Judge Madden's statement of the policy of the statute as being that United States does not, as a tax gatherer, desire to compete with the disappointed depositors of an insolvent bank. See also, *New Jersey Title Guarantee & Trust Co.* v. *Commissioner* (C.A. 2d), decided June 19, 1950.

bank were to set aside in a special fund to retire preferred stock held by former depositors justified the conclusion that the former depositors had a lien on future earnings. Here there was no special fund or other earmarking of the earnings for the benefit of the depositors but, on the contrary, any creditor of taxpayer would be preferred over the former depositors. It was, accordingly, not possible under the rationale of the *Clinton* case for the court below to conclude that a lien existed.

In *Farmers & Merchants Bank, supra,* the former depositors, unlike those in the present case, did not become stockholders but remained creditors and as such were entitled to dividends declared on common stock. The agreement, unlike the present one, required that dividends be declared as earnings arose, subject only to the statutory requirement, permission of state banking officials. The effect of the agreement in light of Nebraska law, as interpreted by the Eighth Circuit, was that all earnings of the bank were required to be paid to the former depositors. Assuming the correctness of the court's interpretation of the agreement and of the state law, we submit that no question remains at all that the statutory requirement of a lien on future earnings [3] was met in that case within the rationale of the opinion of the court below.

---

[3] The Court of Appeals here (R. 33) noted that the facts of this case did not come within any of the definitions of "lien" given in the *Farmers & Merchants Bank* opinion.

CONCLUSION

The decision below is correct. There is no conflict of decisions. The petition for a writ of certiorari should be denied.

Respectfully submitted,

PHILIP B. PERLMAN,
Solicitor General.
THERON LAMAR CAUDLE,
Assistant Attorney General.
ELLIS N. SLACK,
IRVING I. AXELRAD,
Special Assistants to the Attorney General.

JULY, 1950.

☆ U. S. GOVERNMENT PRINTING OFFICE: 1950 894202